



FAIR POLITICAL PRACTICES COMMISSION

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March 10, 2015

Ms. Madeline Kellner
City Councilmember, City of Novato
10 Andreas Court
Novato, CA 94945

Re: Your Request for Advice
Our File No. A-15-021

Dear Ms. Kellner:

This letter responds to your request for advice regarding the conflict of interest provisions of Government Code section 1090. Please note that we do not provide advice on any other conflict of interest restrictions, if applicable, outside the Political Reform Act (the "Act")¹ and Section 1090. We are also not a finder of fact when rendering advice (*In re Oglesby* (1975) 1 FPPC Ops. 71), meaning that any advice we provide assumes the facts the requester provides to us are complete and accurate. If this is not the case, then our advice could be different.

In regard to our advice on Section 1090, we are required to forward your request and all pertinent facts relating to the request to the Attorney General's Office and the Marin County District Attorney's Office, which we have done. (Section 1097.1(c)(3).) We did not receive a written response from either entity. (Section 1097.1(c)(4).) We are also required to advise you that, for purposes of Section 1090, the following advice "is not admissible in a criminal proceeding against any individual other than the requestor." (See Section 1097.1(c)(5).)

QUESTION

Does Section 1090 prohibit you and the Novato City Council from approving a contract entered into between the City of Novato and the firm that employs your spouse?

¹ The Political Reform Act is contained in Government Code Sections 81000 through 91014. All statutory references are to the Government Code, unless otherwise indicated. The regulations of the Fair Political Practices Commission are contained in Sections 18110 through 18997 of Title 2 of the California Code of Regulations. All regulatory references are to Title 2, Division 6 of the California Code of Regulations, unless otherwise indicated.

CONCLUSION

Yes. As explained below, Section 1090 prohibits you and the Novato City Council from approving a contract entered into between the City of Novato and the firm that employs your spouse.

FACTS

You are currently a member of the Novato City Council seeking advice relating to a potential contract between the City of Novato and LSA Associates, an environmental consulting firm. LSA has 9 offices in California and employs approximately 225 persons. Your spouse has been employed by LSA for over 30 years. Currently, he works half-time as an associate biologist performing surveys and other studies. He is not in management and is not a principal of the firm.

Your spouse is a participant in the firm's Employee Stock Ownership Plan ("ESOP"), which makes eligible employees equity owners of the business. Presently, he owns a little more than 3 percent of LSA's outstanding shares. As a participant, he is allowed to vote only on how funds would be distributed to purchase another firm or be distributed if LSA were to be purchased. Depending upon annual firm profitability, the management of LSA determines how much (up to 20 percent of an eligible employee's compensation) LSA contributes into each employee's tax-deferred ESOP account.

Your spouse receives an annual base compensation from LSA that is not dependent on or affected by the proposed contract with the City of Novato. In addition to his base compensation, the firm may pay an annual bonus to your spouse. He is not involved in the decision whether to pay annual bonuses, which is based upon the overall performance of the company each year. In 7 of the last 8 years, bonuses have not been paid to your spouse and the other employees.

Your spouse works out of LSA's Point Richmond office. The proposed contract with City of Novato has been handled by employees working out of LSA's Berkeley office. Your spouse has had no involvement in the procurement, negotiations and/or discussions within LSA or with the City concerning this contract. He will not perform any of the services required under the contract.

ANALYSIS

Section 1090 generally prohibits public officers, while acting in their official capacities, from making contracts in which they are financially interested. Section 1090 is concerned with financial interests, other than remote or minimal interests, that prevent public officials from exercising absolute loyalty and undivided allegiance in furthering the best interests of their agencies. (*Stigall v. Taft* (1962) 58 Cal.2d 565, 569.) Section 1090 is intended "not only to strike at actual impropriety, but also to strike at the appearance of impropriety." (*City of Imperial Beach v. Bailey* (1980) 103 Cal.App.3d 191, 197.)

Under Section 1090, “the prohibited act is the making of a contract in which the official has a financial interest.” (*People v. Honig* (1996) 48 Cal.App.4th 289, 333.) A contract that violates Section 1090 is void. (*Thomson v. Call* (1985) 38 Cal.3d 633, 646.) The prohibition applies regardless of whether the terms of the contract are fair and equitable to all parties. (*Id.* at pp. 646-649.) We employ the following six step analysis.

Step One: Are you subject to the provisions of Section 1090?

Section 1090 provides, in part: “[m]embers of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members.” City councils and their members are plainly covered by this prohibition. (See, e.g., *Thomson v. Call*, *supra*, at p. 645; *City Council v. McKinley* (1978) 80 Cal.App.3d 204, 213.)

Step Two: Does the decision at issue involve a contract?

To determine whether a contract is involved in the decision, one may look to general principles of contract law (84 Ops.Cal.Atty.Gen. 34, 36 (2001);² 78 Ops.Cal.Atty.Gen. 230, 234 (1995)), while keeping in mind that “specific rules applicable to sections 1090 and 1097 require that we view the transactions in a broad manner and avoid narrow and technical definitions of ‘contract.’” (*People v. Honig*, *supra*, at p. 351 citing *Stigall v. City of Taft*, *supra*, at pp. 569, 571.)

Here, a proposed agreement between the City of Novato and LSA is at issue. Thus, the decision involves a contract.

Step Three: Are you making or participating in making a contract?

As a member of the Novato City Council, which must approve any agreement between the City and LSA, you will be making or participating in making a contract.

Step Four: Do you have a financial interest in the contract?

Under Section 1090, “the prohibited act is the making of a contract in which the official has a financial interest” (*People v. Honig*, *supra*, 48 Cal.App.4th at p. 333), and officials are deemed to have a financial interest in a contract if they might profit from it in any way. (*Ibid.*)

Although section 1090 nowhere specifically defines the term “financial interest,” case law and Attorney General Opinions state that prohibited financial interests may be indirect as

² It is noteworthy to point out that Opinions issued by the Attorney General’s Office are entitled to considerable weight (*California Assn. of Psychology Providers v. Rank* (1990) 51 Cal.3d 1, 17.), especially where, as here, it has regularly provided advice concerning Section 1090, et al. (*Thorpe v. Long Beach Community College Dist.*, (2000) 83 Cal.App.4th 655, 662; *Freedom Newspapers, Inc. v. Orange County Employees Retirement System* (1993) 6 Cal.4th 821, 829.)

well as direct, and may involve financial losses, or the possibility of losses, as well as the prospect of pecuniary gain. (*Thomson v. Call*, *supra*, 38 Cal.3d at pp. 645, 651-652; see also *People v. Vallerger* (1977) 67 Cal.App.3d 847, 867, fn. 5; *Terry v. Bender* (1956) 143 Cal.App.2d 198, 207-208; *People v. Darby* (1952) 114 Cal.App.2d 412, 431-432; 85 Ops.Cal.Atty.Gen. 34, 36-38 (2002); 84 Ops.Cal.Atty.Gen. 158, 161-162 (2001).)

In addition, case law and statutory exceptions to Section 1090 make clear that the term “financially interested” must be liberally interpreted. (See, e.g., *People v. Deysher* (1934) 2 Cal.2d 141, 146 [(“h)owever devious and winding the chain may be which connects the officer with the forbidden contract, if it can be followed and the connection made, the contract is void”].) Further, “the certainty of financial gain is not necessary to create a conflict of interest . . . (t)he government’s right to the absolute, undivided allegiance of a public officer is diminished as effectively where the officer acts with a hope of personal financial gain as where he acts with certainty.” (*People v. Gnass* (2002) 101 Cal.App.4th 1271, 1298 (citations omitted).)

With these principles as a backdrop, we turn to the issue concerning the potential conflict of interest this matter presents.³ Instructive on this issue is *Frazer-Yamor Agency, Inc. v. County of Del Norte* (1977) 68 Cal.App.3d 201. In that case, a member of the county board of supervisors was a partner and, upon incorporation, a shareholder in an insurance agency that acted as agent in the procurement of insurance for the county. Although the county supervisor did not share in the commissions from the county’s business and those commissions were not used to cover the agency’s overhead, the Court nevertheless concluded that he had a financial interest within the meaning of section 1090:

Although Fraser did not receive any part of these commissions he nevertheless continued to have a direct financial interest in the business affairs of the agency and to be an active participant in the conduct of its business. We do not apprehend that Fraser divested himself of his financial interest in the agency merely because he did not share in the commissions derived by the agency from the county’s insurance business or merely because none of these commissions were used to defray the operating expenses of the agency. Fraser has and has had an investment in the agency represented by his partnership and shareholder interests. His interest in the agency and in any contracts from which it derives a pecuniary benefit is clearly a financial one because the financial success of the agency inures to his personal benefit. Such success, in turn, enhances the value of Fraser’s interest in the agency. The record discloses that the volume of business procured and placed by the agency is an important consideration in the agency’s relationship with the

³ We note it is well-settled that a member of a board or commission always has a financial interest in his or her spouse’s source of income for purposes of Section 1090. (See, e.g., 78 Ops.Cal.Atty.Gen. 230, 235 (1995).) By the same token, any remote or noninterest exception that would apply to either the spouse or the official is equally applicable to the other. (*Ibid.*)

insurance companies. If the volume of business produced by the agency is profitable the insurance companies pay an amount to the agency on a basis of profit-sharing over and above the ordinary commissions.

The conclusion we have reached is compelled, we believe, by the purpose and intent of section 1090. The object of the Government Code provisions forbidding city officers from being financially interested in any contract made by them in their official capacity or by the body or board of which they are members is to insure absolute loyalty and undivided allegiance to the best interest of the municipality they serve and to remove all direct and indirect influence of an interested officer as well as to discourage deliberate dishonesty.

(*Frazer-Yamor, supra*, 68 Cal.App.3d at pp. 214- 215.)

Here, similar to the situation just described, your spouse receives a base compensation that will not be dependent upon or changed by securing the contract with the City of Novato. But the fact that no financial gain will flow to him directly from that contract is not controlling. Indeed, Section 1090 recognizes that even though your spouse may not directly benefit from the terms of the contract, it is significant that the contract will contribute to the financial health of your spouse's firm, LSA. And as your facts state, depending upon annual firm profitability, the management of LSA determines how much (up to 20% of an eligible employee's compensation) LSA contributes into each employee's tax-deferred ESOP account. In addition, an increase in LSA's profitability could result in a year-end bonus for its employees, including your spouse. This is exactly the type of indirect interest Section 1090 attempts to thwart. (See, e.g., 88 Ops.Cal.Atty.Gen. 106, 107 (2005); see also *People v. Elliott* (1953) 115 Cal.App.2d 410, 418 ["the unlawful interest of a public officer in a public contract which is prohibited, is a personal interest which might interfere with the unbiased discharge of his (or her) duty to the public or prevent the exercise of absolute loyalty and undivided allegiance to the best interests of the governmental unit which he (or she) represents"].)

Accordingly, both you and the City Council will have a prohibitory Section 1090 financial interest in any contract entered into with LSA unless an exception applies.

Step Five: Does either a remote interest or noninterest exception apply?

When Section 1090 applies to one member of a governing body of a public entity, the prohibition cannot be avoided by having the interested board member abstain. Instead, the entire governing body is precluded from entering into the contract. (*Thomson, supra*, at pp. 647- 649; *Stigall, supra*, at p. 569; 86 Ops.Cal.Atty.Gen. 138, 139 (2003); 70 Ops.Cal.Atty.Gen. 45, 48 (1987).)

However, the Legislature has created various statutory exceptions to Section 1090's prohibition where the financial interest involved is deemed a "remote interest," as defined in Section 1091, or a "noninterest," as defined in Section 1091.5.

If a "remote interest" is present, the contract may be made if (1) the officer in question discloses his or her financial interest in the contract to the public agency, (2) such interest is noted in the entity's official records, and (3) the officer abstains from any participation in the making of the contract. (Section 1091(a); 88 Ops.Cal.Atty.Gen. 106, 108 (2005); 83 Ops.Cal. Atty.Gen. 246, 248 (2000).) If a "noninterest" is present, the contract may be made without the officer's abstention, and generally, a noninterest does not require disclosure. (*City of Vernon v. Central Basin Mun. Water Dist.* (1999) 69 Cal.App.4th 508, 514-515; 84 Ops.Cal.Atty.Gen. 158, 159-160 (2001).)

Under the present circumstances, only the "remote interest" specified in Section 1091(b)(2) appears relevant. Under Section 1091(b)(2), an official has a remote interest in a contract entered into by the body or board of which they are a member if they are a "an employee or agent of the contracting party, if the contracting party has 10 or more other employees and if the officer was an employee or agent of that contracting party for at least three years prior to the officer initially accepting his or her office and the officer owns less than 3 percent of the shares of stock of the contracting party; . . ."

Thus, where a councilmember has a financial interest in a contract between his or her private employer and the City, such interest is deemed remote if his or her company had more than 10 employees, the councilmember had worked for at least three years and owned no more than 3 percent of the company's stock. Here, although LSA has more than 10 employees and your spouse had worked there for more than three years prior to your taking office, the exception does not apply because he owns more than 3 percent of the shares of LSA's stock.

Step Six: Does the rule of necessity apply?

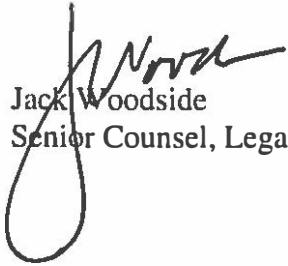
In limited circumstances, the "rule of necessity" has been applied to allow the making of a contract that Section 1090 would otherwise prohibit. (88 Ops.Cal.Atty.Gen. 106, 110 (2005).) Under the rule of necessity, a government agency may acquire an essential service, despite the existence of a conflict, when no source other than that which triggers the contract is available; the rule "ensures that essential government functions are performed even where a conflict of interest exists." (*Eldridge v. Sierra View Hospital Dist.* (1990) 224 Cal. App. 3d 311, 322.) You have provided no facts to suggest the "rule of necessity" would apply in the present situation.

Accordingly, based on the facts provided, a prohibitory conflict of interest under Section 1090 exists preventing you and the Novato City Council from approving a contract between the City and LSA.

If you have other questions on this matter, please contact me at (916) 322-5660.

Sincerely,

John W. Wallace
Assistant General Counsel

By:  Jack Woodside
Senior Counsel, Legal Division

JW:jgl